

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Villines Analyst: Rachel Coco Bill Number: AB 2341
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: February 23, 2006
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Minimum Franchise Tax/Annual Tax Relief and Certification For Periods of Inactivity

SUMMARY

This bill would provide relief from the minimum franchise and annual tax for certain entities.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to simplify the entity dissolution and cancellation process by allowing entities more time to complete the steps necessary to dissolve or cancel their registration.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and would be operative as of that date. Certain provisions are operative for taxable years beginning on or after January 1, 2006. Other provisions apply with respect to tax liability for prior taxable years.

POSITION

Pending.

SUMMARY OF SUGGESTED AMENDMENTS

This bill limits relief from the minimum franchise tax for certain corporations to the taxable year in which a tax clearance certificate is issued. Since the actual issuance of a tax clearance certificate can occur more than one taxable year after the taxable year a corporation ceases to do business, the bill does not necessarily provide relief from the minimum franchise tax for the entire period after a final return was filed. Amendments have been provided to address this concern.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <u>X</u> PENDING

Department Director**Date**

Selvi Stanislaus

03/30/06

ANALYSIS

FEDERAL/STATE LAW

Federal law does not impose a minimum franchise tax.

Every corporation, including a limited liability company (LLC) classified as a corporation, incorporated or organized in, qualified to do business in, or doing business in California must annually pay to the state a minimum franchise tax of \$800. The minimum franchise tax applies from the earlier of the date of incorporation or organization, qualification, or commencing to do business within California until the date of dissolution, surrender, or if later, the date the corporation ceases to do business in California. This liability exists regardless of whether the corporation is earning income. Every corporation that incorporates or is qualified to do business in this state on or after January 1, 2000, is not subject to the minimum franchise tax for its first taxable year. In addition, a corporation is not subject to the minimum franchise tax if the corporation did not do business in this state, and the taxable year was 15 days or less.

Every limited partnership, LLC not classified as a corporation, and limited liability partnership (LLP) registered, organized, or doing business in California must pay to the state an annual tax in an amount equal to the minimum franchise tax until a Certificate of Cancellation or a Notice of Change of Status, as applicable, is filed with the Office of the Secretary of State (SOS). In addition, an LLC not classified as a corporation must annually pay a fee determined by the total income of the LLC.

Generally, a corporation, an LLC regardless of how classified, and an LLP organized within the state or registered with SOS must receive a tax clearance certificate from the Franchise Tax Board (FTB) before SOS will file the appropriate termination documents to extinguish the existence of the entity or cancel its qualification to conduct business in California. During the period between the filing of a certificate of dissolution with SOS and the issuance of a tax clearance certificate by FTB, a domestic corporation (organized in California) is considered "conditionally dissolved." A conditionally dissolved domestic corporation does not accrue liability for the minimum franchise tax.

To obtain a tax clearance certificate, a Request for Tax Clearance Certificate Form is completed and sent to FTB for review and resolution of the entity's tax liability. FTB is required within 30 days either to issue the certificate or to notify the person requesting the certificate of the conditions that must be met before the certificate will be issued.

If the taxpayer files a tax return marked "final return" without having previously filed the tax clearance request described above, FTB will treat the return as a request for a tax clearance certificate. The taxpayer will be provided with the forms, instructions, and other documents that are required to be filed with SOS or FTB to complete the withdrawal or dissolution process.

Before a tax clearance certificate can be issued, the entity must have filed all required tax returns and paid all fees, taxes, penalties, and interest associated with those returns. The tax clearance certificate may be issued based on one of the following:

- Taxes paid and returns filed,
- An assumption of tax liability by an individual who can prove satisfactory financial responsibility,
- A surety bond generally in the amount equal to twice the estimated tax plus interest, or
- A non-interest bearing cash deposit that is held by FTB as security.

THIS BILL

This bill would provide that the minimum franchise tax or the annual tax would not be assessed for a taxable year if three conditions are met:

- 1) The entity files a final annual tax or minimum franchise tax return for a taxable year,
- 2) The entity did not do business in California after that year, and
- 3) The entity files documents for dissolution, surrender, or cancellation within 12 months of the due date of that final return, without regard to extension.

This bill would also permit certain suspended corporations to seek dissolution without payment of the accrued liability for the minimum franchise tax for years in which the corporation was inactive and not doing business.

IMPLEMENTATION CONSIDERATIONS

To implement this bill, the department would need to determine whether a suspended corporation seeking dissolution meets the requirements of the bill for each year in question. As a result, the department would need assistance from the Employment Development Department and the Board of Equalization to determine whether an entity had ceased doing business in any given tax year.

Implementing this bill would also require minor programming changes to the department's systems, which can be accomplished during normal annual updates.

TECHNICAL CONSIDERATIONS

A minor error was found within the language. Amendment 2 has been provided to correct it.

LEGISLATIVE HISTORY

AB 547 (Maldonado, 2001/2002) contained the same language as this bill. AB 547 failed to pass out of the originating house by the constitutional deadline.

SB 947 (Committee on Judiciary, Stats. 1997, Ch. 17) allowed the cancellation of tax for certain suspended banks and corporations that met specific criteria. The statute was repealed by its own provisions on January 1, 1999.

OTHER STATES' INFORMATION

The states of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* were reviewed because the tax laws in those states are similar to California's tax laws.

Each of these states has a different process for allowing business entities to dissolve, cancel, or withdraw. Generally, each of these states requires that the business entity resolve any tax obligations prior to the state recognizing the business entity dissolution, cancellation, or withdrawal.

FISCAL IMPACT

The department's business entities tax system (BETS) file indicates there are approximately 650,000 suspended entities. It is not known how many of these entities would seek the relief provided by this bill, but the costs associated with processing those cases are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2341 As Introduced 2/23/06, assumed effective on 1/1/2007 [\$ In Millions, Rounded to nearest \$500K]			
	2006-07	2007-08	2008-09
1. Relief from minimum tax in year of dissolution	\$0	-\$1.5	-\$3.0
2. Waive amounts outstanding for inactive entities seeking to dissolve	-\$0.5	-\$1	-\$1
Total	-\$0.5	-\$2.5	-\$4

Revenue Discussion

1. No minimum tax in year of dissolution

Roughly 27,000 inactive business entities seek to dissolve their legal status formally each year. Because domestic corporations are granted "conditional" dissolution status, they are not impacted by this proposal. As such, the revenue impact of this proposal is based on the number of foreign and non-corporate entities that terminate in any given year.

An estimated 4,600 foreign corporations cease doing business in California annually. Another 2,100 non-corporate entities (limited partnerships and limited liability companies) go out of business each year. This estimate assumes all businesses eligible for the proposed relief are not doing any business in California during the year they seek to dissolve. Also, it is assumed the dissolution request was received within the applicable 12-month period commencing with the due date of their final return.

The projected number of entities impacted by this combined relief provision is roughly 6,700 annually (4,600 + 2,100). The department generally collects about half of the additional annual/minimum tax liabilities incurred. Thus, the estimated annual revenue loss of this provision is approximately \$3 million (6,700 x \$800 x .5). Based on the timing of amounts otherwise collected under current law, the first full-year impact would occur in 2008-09.

2. Suspended entities that revive

At last count, the number of entities on BETS with a status of inactive is around 650,000. It is not known what percentage has submitted a final return, though the majority of these taxpayers have been suspended for at least two years. The probability of collecting any tax from defunct business entities is very low, as the vast majority never attempts to revive their legal status.

Department staff that process reviver cases resolve about 3,000 each year. Roughly 85% of reviver cases involve entities that seek to restore their legal status from “suspended” back to “active.” It is not known what amount of minimum franchise or annual tax, penalties, and interest is attributed to the 15% that revive solely to dissolve. Assuming an average period of inactivity of three years, or a liability of \$2,700 including penalties and interest, it is estimated that this provision would result in losses of \$1.2 million annually ($3,000 \times 15\% \times \$2,700$). The first full-year impact from this provision does not occur until 2007-08, as reflected in the second row of the above table.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2341
As Introduced February 23, 2006

AMENDMENT 1

On page 5, line 5, strikeout "the taxable year in which" and insert:
a taxable year if

AMENDMENT 2

On page 5, line 13, strikeout "board" and insert:
Board

AMENDMENT 3

On page 5, line 14, strikeout "the" and insert:
a

AMENDMENT 4

On page 5, line 18, strikeout "the" and insert:
that

AMENDMENT 5

On page 5, line 20, strikeout "this paragraph" and insert:
subparagraph (B)